

## **OFFICE OF MARKET OVERSIGHT AND INVESTIGATIONS AUDIT PROCESS**

The Division of Audits and Accounting within the Office of Market Oversight and Investigations, helps ensure compliance with the Commission's statutes, rules, regulations, and orders by conducting a wide array of financial and operational audits of jurisdictional entities. The following summarizes the audit process used by the division to conduct financial and operational audits, including Standards of Conduct audits.

On October 20, 2005, the Commission issued a Notice of Proposed Rulemaking (NOPR) RM06-2-000, *Procedures for Disposition of Contested Audit Matters*, 70 Fed. Reg. 65866 (November 1, 2005), FERC Statutes and Regulations ¶ 32,592 (2005) seeking comment on proposed revisions to the regulations governing contested audit matters. This audit process document will be updated to reflect any subsequent Commission order resulting from the proposed rulemaking.

### **PLANNING, PREPARATION, AND EXECUTION PHASE**

#### **The Audit Team**

The audit team may be comprised of accountants, attorneys, auditors, energy information analysts, and others depending on the nature of the audit. This multi-disciplined audit team will vary, providing the appropriate skill sets to the type of audit being conducted by the Division of Audits and Accounting.

#### **Commencement Letter**

The Chief Accountant sends the company selected for audit a public commencement letter that describes the purpose and scope of the audit, and the staff's authority to conduct the audit. The commencement letter also identifies all audit team members and provides appropriate contact information. Further, as a newly implemented procedure, the commencement letter identifies the names and contact numbers of OMOI leadership. Although the commencement letter is a public document which can be found in eLibrary, all other correspondence with the company under audit, with the exception of the company's written response to the draft audit report and the final audit report, is non-public. Financial audits are identified by a docket number with a prefix of "FA." Operational audits are identified by a docket number with a prefix of "PA."

#### **Data Collection**

The audit team gathers a sufficient amount of evidence to document the work performed and to serve as the basis for the conclusions reached during the course of the audit. The

information is gathered generally through:

*Data Requests* - The primary method of obtaining data is through data requests to the audited company. The data obtained through data requests could include financial and operational information, procedures manuals, organization charts, reports, email and voice mail records, and studies. Depending on the circumstances, the company will provide this data electronically or as paper documents.

*Site Visits* - Site visits help ensure the auditors correctly interpret information provided by the company, offer an opportunity to collect relevant materials on-site, observe processes, and offer an opportunity to conduct face-to-face interviews, among other things.

*Interviews* – The auditors conduct interviews in person and over the phone. Interviews enhance staff understanding of the data that the company has provided and the policies, processes, and procedures of the company.

### **Site Visit Opening Conference**

At the start of each site visit, the audit team conducts a meeting with the company's management. The company selects whom from its staff it wishes to attend this meeting. The purpose of this meeting is to explain the audit process, identify what information is required during the site visit, and to discuss any issues or concerns that have arisen since the issuance of the commencement letter. The team will also explain to company management how they can discuss unresolved issues with OMOI management, and provide contact information for the audit manager, branch director, Chief Accountant, deputy office director, and office director.

### **Site Visit Exit Conference**

At the conclusion of each site visit, the audit team conducts a conference with the company's management. The purpose of this meeting is to discuss any potential findings or areas of concern, identify audit work that the team needs to complete, and clarify any outstanding data requests. The team will again explain to the company's management how they can contact OMOI's leadership to discuss any issues or concerns regarding the audit.

### **Analysis**

As data are collected from the company under audit, the team compiles and analyzes the data. A customized audit program guides the audit team's analysis. The audit team analyzes information gathered from multiple sources, including FERC filings, as well as public records from other governmental agencies, state commissions, and the media. Advanced analysis may require the creation of complex spreadsheets and databases, and

the use of statistical sampling to test for potential non-compliance of Commission rules, regulations, and orders.

### **Documentation**

As required by Generally Accepted Government Auditing Standards, the team documents all audit work in the form of non-public working papers. Working papers document the objective, scope, source, methodology, and results of each audit step, and reference all findings to the Commission's statutes, precedents, rules, regulations, and orders. More importantly, working papers support the audit staff's findings, conclusions, and recommendations. The standard for working papers is that they can be understood by an experienced auditor examining the same transactions and records.

### **Wrap-Up Conference**

The purpose of a wrap-up conference is to discuss the staff's preliminary findings and recommendations with the company. The wrap-up conference may be conducted in person or through a conference call. Prior to conducting a wrap-up conference, the audit staff receives OMOI leadership's approval of its preliminary findings and recommendations, and has consulted with the Office of the General Counsel (OGC), the Office of Markets, Tariffs and Rates (OMTR), and the Office of Energy Projects (OEP), as appropriate. The audit staff informs the company that OGC, OMTR, and OEP, have reviewed the draft audit report if that is the case. The audit staff also explains the process regarding the issuance of the draft and final audit reports and the fact that the company will have an opportunity to comment in writing on the draft report. Further, staff informs the company that OGC, OMTR, OEP and the Commission will see the company's response before issuance of any letter order containing significant, unique or contested audit matters.

### **Issuance of Draft Audit Report**

A draft audit report is a non-public document issued to the audited company. The draft report contains the audit staff's findings and recommendations for corrective action.

The audit staff will distribute a draft audit report that contains significant, unique or contested audit matters to senior staff of OMOI, OGC, OMTR, and OEP, as appropriate, for comments before submitting it to the audited company. OMOI leadership approves the issuance of the draft audit report to the audited company.

The draft report provides the company an opportunity to clarify findings and ensure that the team did not misinterpret information provided during the audit. Upon review of the draft audit report, the company may discuss the findings and recommendations with the audit staff, submit additional information for the audit staff's consideration, and may

submit a written response to the report. The audit staff will take into consideration any additional information the company provides during this process before reaching its final conclusions. The written response the company provides to the draft report should state whether the company agrees or disagrees with each recommendation and when the company will complete the recommended corrective action. If the company disagrees with a recommendation, the company is requested to provide an alternate resolution. Additional discussions often take place after the audit team receives the company's written response.

### **Issuance of Final Report**

The audit staff will circulate to OGC, OMTR, OEP and the Commission, as appropriate, the proposed final audit report with the company's response, including any finding or recommendation with which the company has taken issue.

The Commission may issue the audit report as a Commission order or the Director of OMOI may issue it as a letter order under delegated authority (see 18 CFR § 375.314(j) (2005)). The order will state that the company has agreed to certain findings and recommendations for corrective action. Further, the order will approve and direct the recommended corrective action, and will constitute final agency action, except for disputed matters.

In the case of financial audits, the order will identify disputed audit issues, and will state that it does not constitute final agency action on these matters. The order will request that the company notify the Commission in writing within a specified number of days as to whether it consents to the disposition of the contested matters in accordance with the shortened hearing procedure provided for in Parts 41 or 158 of the Commission's regulations. A NOPR is pending to extend this provision to operational audits, RM06-2-000, *Procedures for Disposition of Contested Audit Matters*, 70 Fed. Reg. 65866 (November 1, 2005), FERC Statutes and Regulations ¶ 32,592 (2005).

### **Disposition of Contested Audit Matters**

If a company undergoing a financial audit disagrees with a finding, the procedures set forth in Parts 41 or 158 of the Commission's regulations will govern. Under those procedures, the company may elect a shortened paper procedure or a hearing before an administrative law judge to resolve the disputed matters.

Under the shortened procedures of Parts 41 and 158, the Commission issues a notice setting a schedule for the filing of memoranda concerning the disputed matters. The company electing the use of the shortened procedure and any other interested parties, including the audit staff, must file by the date specified by the Commission in the notice, an initial memorandum that addresses the relevant facts and applicable law that supports

the position or positions taken regarding the matters at issue. In the notice, the Commission will also set a date for the filing of reply memoranda, which may be filed only by participants that filed initial memoranda. Based on these filings, the Commission issues an order on the disputed matter.